Finance Watch
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DG FISMA Public Hearing on the Call for Evidence - A review of the EU regulatory framework for financial services
17 May 2016

Session 1: Towards a cumulative impact assessment – Have the reforms been coherent, efficient and effective in reaching our policy objectives?

Opening statement by Christophe Nijdam, Secretary General of Finance Watch

Finance Watch supports cutting red tape and rules that no longer protect citizens.
But as any surgeon will tell you, never cut too far.

As a public interest advocate, I have three tough comments to make before addressing Thomas's two questions.

First, the financial crisis was caused by too little regulation, not too much. The crisis and Great Recession it caused killed more jobs and growth than any regulation in EU history. This is worth repeating: the crisis was caused by too little financial regulation.

Second, there is no trade-off between economic growth and financial stability. Stability is needed for growth. Economic risk-taking is needed for growth. Excessive financial risk-taking is not. Evidence shows that an overgrown financial system is an impediment and a drag on jobs and growth, and occasionally catastrophic. There is no regulatory trade-off here: proper financial regulation makes the financial system work for the long term good of the economy, not against it.

Third, the timing of this cumulative impact review is premature. Many new prudential rules are not yet implemented and it is too soon to see their benefits. But their costs can already be estimated, which will inevitably tilt the review against proper regulation and therefore

against jobs and growth. Let's make sure that this review doesn't lead us towards deregulation and the next crisis.

Thomas's first question is whether recent reforms have been efficient and effective in meeting regulatory objectives. In our view, prudential reforms have not delivered economic and financial stability, or restored trust, or been clear and simple rules.

On complexity, for example, CRD IV has not addressed the well-known problems with banks' internal models. The result is that Tier 1 capital is not trusted by the financial markets themselves; its complexity disguises the true state of banks' health. And it encourages regulatory capture. A simple and robust leverage cap would serve investors and supervisors far better, yet there are hints that the planned EU leverage rules could be weakened as part of this review. Such a backwards step would be impossible to justify in a future crisis.

On financial stability and moral hazard, EU citizens are astonished that it has not been possible to deliver a meaningful bank structure reform in line with the Liikanen and Barnier proposals. The giant market failure of too-big-to-fail banking – which burdens us with contagion in resolution, lack of competition, conflicts of interest, implicit subsidy and resource miss-allocation - remain largely unsolved.

Instead, steps to promote shadow banking via the Capital Markets Union promote those same business models and come without any measures to tackle the extra interconnectedness and procylicality or provide an effective backstop, ignoring the lessons from the crisis.

The second question is about coherence and I will make only one brief point. Reforms such as CRD IV and MiFID2 aim to improve financial stability and thus stable, long-term growth. So do CMU measures to promote equity financing, including across borders. But other

aspects of CMU, such as STS, seem more focused on increasing the profitability of the European financial sector.

There is therefore a lack of coherence between reforms that protect on one hand long term growth and jobs and those that endanger them on the other hand by promoting excessive financial risk-taking. The key to removing this incoherence is simple: it is to avoid mixing financial regulation with boosting the financial sector.